Supreme Court, U.S.
FILED

97-1801 MAY 7 1998

OFFICE OF THE CLERK

No. _____

In The
Supreme Court of the United States
October Term, 1997

HAROLD S. POLLIN,

Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF OREGON,

Respondent.

Petition For Writ Of Certiorari
To The Supreme Court Of The State Of Oregon

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Can a state constitutionally tax a lessee of exempt, state-owned property for the value of the unrestricted fee simple interest, which the lessee does not own and cannot use?

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PARTIES TO THE PROCEEDINGS

Petitioner before this Court, formerly appellant before the Oregon Supreme Court and plaintiff before the Oregon Tax Court, is Harold Pollin, an individual.

Respondent before this Court, formerly respondent before the Oregon Supreme Court and defendant before the Oregon Tax Court, is the Department of Revenue, State of Oregon, a government entity.

PETITION FOR WRIT OF CERTIORARI

Petitioner Harold Pollin respectfully prays that a writ of certiorari issue to review the judgment of the Oregon Supreme Court entered in the above-entitled proceeding on February 12, 1998.

OPINIONS BELOW

The opinion of the Oregon Supreme Court affirming the Oregon Tax Court is reported at 326 Or. 427, and is reprinted in the appendix hereto ("App.") at A. The opinion of the Oregon Tax Court is reported at 14 Or. T. R. 96, and is reprinted at App. B.

JURISDICTION

Petitioner filed an action in the Oregon Tax Court appealing the real property tax assessed against Petitioner for tax year 1993-94, on the grounds, *inter alia*, that the amount taxed Petitioner in violation of the United States Constitution, because the assessment taxed Petitioner for property he did not own and could not use. On January 10, 1997, the Oregon Tax Court affirmed the assessment. Petitioner appealed to the Oregon Supreme Court on the grounds, *inter alia*, that the assessment unconstitutionally taxed Petitioner, the owner of a

lease, for the value of the property as if held in fee simple. On February 12, 1998, the Oregon Supreme Court affirmed the decision of the Oregon Tax Court. The jurisdiction of the Court to review the judgment of the Oregon Supreme Court is invoked under 28 U.S.C. § 1257(a).

PERTINENT STATUTORY PROVISIONS

ORS 307.110 provides in pertinent part:

> Except as provided in ORS 307.120, all real and personal property of this state or any institution or department thereof or of any county or city, town or other municipal corporation or political subdivision of this state, held under a lease or other interest or estate less than a fee simple, by any person whose real property, if any, is taxable, except employees of the state, municipality or political subdivision as an incident to such employment, shall be subject to assessment and taxation for the real market or specially assessed value thereof uniformly with real property of nonexempt ownerships.

STATEMENT OF THE CASE

Petitioner Harold Pollin operates a Sheraton Hotel on property adjacent to the Portland International Airport ("the property") on land owned by the Port of Portland ("the Port"), situated in Multnomah County, Oregon. Plaintiff operates the hotel pursuant to a lease from the Port executed in 1972 ("the lease"). The lease significantly limits Petitioner's use of the property, including, *inter alia*, restricting Petitioner's use to the operation of a Sheraton motor hotel. In order to operate a Sheraton, plaintiff was required to obtain a franchise agreement from Sheraton Corporation, which contains further restrictions on Petitioner's use of the property. As of July 1, 1993, the assessment date in question, nineteen years and four months remained on the term of the lease.

Respondent, through the Multnomah County appraisal office, assessed to Petitioner the value of the property as if owned by Petitioner in fee simple. Petitioner appealed to the Oregon Tax Court, asserting, together with arguments as to the meaning of the language of ORS 307.110, that it is a violation of the United States Constitution to assess a lessee for the value of property beyond the limited rights held by the lessee. At the hearing before the Oregon Tax Court, the evidence was uncontested that the value of Petitioner's rights to use the property under the terms of the lease was $4,595,000. Respondent testified, through the Multnomah County appraisers, that all appraisers are instructed to ignore the terms of leases of state-owned property and assess the lessee as if the property were owned in fee. Petitioner's assessment was determined by

following that mandate, with the lease terms ignored, resulting in an assessment of $9,460,000.

The Oregon Tax Court affirmed the assessment for the tax year 1993-94. Petitioner filed a direct appeal to the Oregon Supreme Court, reasserting its statutory and constitutional arguments. On February 12, 1998, the Oregon Supreme Court affirmed the decision of the Oregon Tax Court. Oregon's highest court left no doubt that ORS 307.110 requires leased, state-owned property to be taxed to the lessee as if held by the lessee in fee simple. The Oregon Supreme Court rejected Petitioner's federal constitutional arguments without discussion.

REASONS FOR GRANTING THE WRIT

Petitioner holds limited rights to use the property pursuant to a lease. He does not own the property in fee simple and cannot use the property as if it were owned in fee. Yet Respondent, in an effort to tax property the Oregon Legislature has deemed exempt, seeks to assess to Petitioner the value of the property as if he owned it in fee, more than twice (and nearly $5 million more than) the value of plaintiff's ownership interest in, or use of, the property. That assessment is completely arbitrary and grossly unfair, taxing to Petitioner the value of property he does not own and cannot use, with no rational basis for doing so.

I. The Due Process Clause Of The United States Constitution, Applicable To The States Through The Fourteenth Amendment, Precludes Assessing A Taxpayer For The Value Of Property The Taxpayer Does Not Own And Cannot Use.

There is no dispute that Petitioner is being taxed for the value of property he does not own and cannot use. The Oregon Supreme Court, in interpreting ORS 307.110, held that lessees of state-owned property are responsible for taxes on the value of the fee simple interest. 326 Or. at 433. Accordingly, Petitioner, who is admitted by all to hold no ownership or use rights in the property beyond $4,595,000, has been assessed a tax valuation of $9,460,000, the value of the fee interest.

State legislatures are given discretion in taxing property within their borders. However, that discretion is limited by the Due Process clause of the United States Constitution, which prohibits a state tax law, or interpretation or application thereof, which is palpably arbitrary or grossly unequal in its application to the persons concerned. *See Mt. St. Mary's Cemetery Asso. v. Mullins*, 248 U.S. 501, 63 L.Ed. 383, 39 S.Ct. 173 (1919). A state tax law applied as the Oregon Supreme Court commands "results in such flagrant and palpable inequality between the burden imposed and the benefit received as to amount to the arbitrary taking of property without just compensation -- 'to spoliation under the guise of exerting the power of taxing.' [citation omitted]." *Dane v. Jackson*, 256 U.S. 589, 599, 65 L.Ed. 1107, 41 S.Ct. 566 (1921). Arbitrary exertion of the taxing power is in substance and effect a direct

exertion of a different and forbidden power, such as the confiscation of property.

This Court held in *Air-Way Electric Appliance Corp. v. Day*, 266 U.S. 71, 84, 45 S.Ct. 12, 69 L.Ed. 169 (1924), that "[w]hen a basis of taxation is taken which does not reflect the value of the privilege sought to be taxed, there is a want of due process and a denial of the equal protection of the law."

In the present case, there can be no dispute that the assessed, fee simple value does not reflect the value of the privilege sought to be taxed. That privilege is Petitioner's use of the property pursuant to the lease, which has no value in excess of Petitioner's leasehold rights. The State of Oregon, however, arbitrarily has determined that Petitioner should be taxed for the value of the fee simple interest, regardless of whether that interest or Petitioner's use of the property bears any relation to the value of the fee simple ownership or a fee owner's use of the property.

Despite the Due Process requirement that a state tax bear some non-arbitrary relation to the privilege sought to be taxed, the State of Oregon has made no effort to determine if there is any relation whatsoever between the assessed value and Petitioner's use of the property. Respondent, through the Multnomah County taxing authorities, has determined that a lessee's ownership rights or use of the property pursuant to a lease is to be consciously ignored in determining the assessed value for taxation. Similarly, the Oregon Supreme Court refused to offer any rational connection between the assessed

value and plaintiff's property rights, rejecting Petitioner's constitutional arguments without discussion. The result is that Petitioner is arbitrarily taxed for the value of property he does not own and cannot use, under a valuation method which bears no relation to Petitioner's use of the property.

In effect, taxing Petitioner for the value of the fee simple interest is nothing more than a taking of Petitioner's property without just compensation. *Dane, supra*; *see also Henderson Bridge Co. v. Henderson City*, 173 U.S. 592, 43 L.Ed. 823, 19 S.Ct. 553 (1899).

The State of Oregon has been down this path before, recently. In *Dolan v. City of Tigard*, 512 U.S. 374, 384, 129 L.Ed.2d 304, 114 S.Ct. 2309 (1994), the state brushed aside constitutional limitations on imposing public burdens upon private citizens. There the state took away Dolan's property rights. Here, the state would tax to Petitioner property rights he does not have. "One of the principal purposes of the Takings Clause is 'to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Dolan*, 512 U.S. at 384, *quoting Armstrong v. United States*, 364 U.S. 40, 49, 4 L.Ed.2d 1554, 80 S.Ct. 1563 (1960). Where there is no rational nexus between the burden imposed and the benefit received, the state action constitutes a taking. *Dolan*, 512 U.S. at 385.

Petitioner does not contest that his use of the property is subject to taxation, as Petitioner should bear his portion of the tax burden assumed by the public as a whole. But the State of

Oregon has required Petitioner to pay for more than his share of the public burden. Under the mandates of the Due Process clause, Petitioner cannot be required to pay a portion of the public burden through a valuation method which bears no relation to his leasehold interest or use of the property.

II. The Question Presented Is Important And Will Affect Subsequent Property Tax Assessments For Lessees Of State-Owned Property.

Petitioner's appeal to the Oregon Supreme Court directly presented for the first time the valuation of property held under lease and subject to taxation under ORS 307.110. Following the holding therein, lessees of state-owned property in Oregon will be taxed for the fee simple value of the property, regardless of whether the value of the lessee's use bears any relation to the value of the fee simple use. These taxpayers have no constitutional remedy in Oregon, with the Oregon Supreme Court having rejected Petitioner's federal due process challenges without discussion. In the absence of review by this Court, these taxpayers will be subject to taxation beyond the value of any property they own or use. In cases such as the present, where the taxpayer owns property rights far less valuable than the fee simple, the consequences are grossly unfair and palpably arbitrary.

This problem of creeping takings from and impositions on private citizens dealing with the state will grow in dimension as the state grows richer. Increased value in state lands inevitably will lead to increased pressure for development of those lands.

As the state retains its fee ownership interests, the dangerous temptations will mount to tax the user of some of the land as if he owned all of the land. This Court should act now to bring this unconstitutional creep to a halt.

CONCLUSION

For the reasons stated herein, the decision of the Oregon Supreme Court is a direct affront to the liberties and due process each citizen of the United States is guaranteed by the Constitution. Without rational limitation on the state's ability to assess taxes, Oregon will be free to determine taxes based on arbitrary methods according no relation to the property subject to taxation. The United States Constitution forbids this. The Court should grant this petition for certiorari.

Respectfully submitted,

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APPENDIX A

FILED: February 12, 1998

IN THE SUPREME COURT
OF THE STATE OF OREGON

HAROLD S. POLLIN,

Appellant,

v.

DEPARTMENT OF REVENUE,
State of Oregon,

Respondent.

(OTC 3812; SC S44044)

On appeal from the Oregon Tax Court.*

Carl N. Byers, Judge.

Argued and submitted January 5, 1998.

Arden E. Shenker, of Law Offices of Arden E. Shenker, Portland, argued the cause for appellant. With him on the briefs was Gregory L. Baird, of Gordon & Polscer, Portland.

Marilyn J. Harbur, Assistant Attorney General, Salem, argued the cause for respondent. With her on the brief was Hardy Myers, Attorney General.

*14 OTR 96 (1997)

Before Carson, Chief Justice, and Gillette, Van Hoomissen, Graber, and Durham, Justices.**

GRABER, J.

The judgment of the Tax Court is affirmed.

**Fadeley, J., retired January 31, 1998, and did not participate in this decision; Kulongoski, J., did not participate in the consideration or decision of this case.

GRABER, J.

The main issue in this case is how to value public property that is leased by a nonexempt lessee: Does ORS 307.110 (1) (1995)[1] subject to taxation (a) the full value of the leased property, or (b) only the value of the leasehold interest? The Tax Court held that ORS 307.110(1) (1995) provides for taxation of the full value of the leased property. On taxpayer's appeal, we affirm.

Taxpayer does not challenge the Tax Court's factual findings.[2] Accordingly, we take these pertinent findings from the Tax Court's opinion:

> "The Port [of Portland (Port)] is a municipal corporation and operates a wide range of facilities, including the Portland International Airport. In 1972, taxpayer and the Port executed a lease for land immediately adjacent to an airport runway. The lease obligated taxpayer to construct improvements to be used as a full-service Sheraton Motor Hotel. The lease restricts the use of the property to a 'motor hotel,' unless the lessee obtains the lessor's written consent for another use. The original lease term is 40 years, with a 10-year option. The rent is based on a percentage of income with

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[1] The text of ORS 307.110(1) (1995) appears below, ___ Or at ___ (slip op at 4).

[2] Because the material facts are not in dispute, we need not decide whether the present or previous version of ORS 305.445 applies in this case. That statute now provides in part that this court's "review of either a decision or order of the tax court judge shall be limited to * * * lack of substantial evidence in the record to support the tax court's decision or order." ORS 305.445 (1995) provided for de novo review.

a minimum annual rent. Taxpayer also agrees to pay any taxes that might be imposed on the premises. The lease requires taxpayer to maintain the improvements to original standards and also specifies a minimum original dollar investment. No modifications can be made to the improvements without the Port's approval. The lease also grants taxpayer an option to obtain use of adjoining land for expansion of the hotel, but that option expired.

"Title to the improvements remains with taxpayer until termination of the lease, at which time the Port can elect to accept title or require taxpayer to remove the improvements. The lease also contains provisions for insurance, damage, condemnation, assignment, holding over, default, and other usual terms. Because of the location, taxpayer agrees to abide by FAA rules and the Port's rules governing the airport. The Port expressly reserves the right to maintain flights over the property with the consequent noise. The motor hotel and its restaurant must operate 365 days per year. The Port seeks to maximize its income and can disapprove of particular employees of taxpayer. Subsequent amendments to the original lease pertain primarily to rent and options to expand the hotel area. Taxpayer may pledge the improvements, but not the land, as security for a loan." Pollin v. Dept. of Rev., 14 OTR 96, 97-98 (1997).

For the 1993-94 tax year, the county assessor assessed the real market value of the land that taxpayer leased from the Port, as well as the real market value of the improvements that taxpayer owned. The assessed values were $1,246,000 for the land and $8,214,000 for the improvements, for a total assessed value of $9,460,000. Taxpayer appealed that assessment, unsuccessfully, to the Department of Revenue (department). Thereafter, taxpayer filed a complaint in the Tax Court.

The Tax Court concluded that ORS 307.110(1) (1995) provides for assessment of the full amount of the real market value of the leased land. Id. at 100. The Tax Court further concluded that the length of the remaining term of a lease is not a "governmental restriction as to use" within the meaning of ORS 308.205(2)(d). Id. at 101-02. The Tax Court also rejected the parties' evidence of value. It rejected taxpayer's appraisal, which suggested that the assessed value of the subject property was too high, because that appraisal analyzed taxpayer's leasehold interest instead of analyzing the full value of the leased land. The court rejected the department's appraisal, which suggested that the assessed value of the subject property was too low, because that appraisal failed to view any of the conditions in the lease as "governmental restriction[s] as to use" under ORS 308.205(2)(d). Id. at 105-06. The Tax Court held that the assessed value of the land and improvements — $9,460,000 — was the real market value of the subject property in the light of all the evidence, and the court sustained the department's order of assessment. Id. at 106-07.

On appeal, taxpayer first argues that the Tax Court misconstrued ORS 307.110(1) (1995), which provides:

> "Except as provided in ORS 307.120,[3] all real and personal property of this state or any institution or department thereof or of any county or city, town or other municipal corporation or political subdivision of this state, held under a lease or other interest or estate less than a fee simple, by any person whose real property, if any, is taxable, except employees of the state,

[3] That exception is not pertinent to the present case.

> municipality or political subdivision as an incident to such employment, shall be subject to assessment and taxation for the real market or specially assessed value thereof uniformly with real property of nonexempt ownerships."[4] (Emphasis added.)

We apply the template established in PGE v. Bureau of Labor and Industries, 317 Or 606, 610-12, 859 P2d 1143 (1993), to construe that statute.

Taxpayer reads ORS 307.110(1) (1995) to provide for the assessment and taxation of "property * * * held under a lease" and then argues that "ORS 307.110(1) limits the 'property' subject to taxation to that 'held under lease.' By doing so, the legislature has expressed its intent that only the property rights 'held under lease' shall be subject to taxation." (Emphasis added.)

Taxpayer's argument suffers from two difficulties. The first is that it transforms the term "property * * * held under a lease" into the term "property rights * * * held under a lease." We are not free to add to a statute that the legislature wrote. ORS 174.010; PGE, 317 Or at 611.

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[4] In 1997, the legislature amended ORS 307.110(1) by replacing the words "real market" with the word "assessed." Or Laws 1997, ch 541, § 101. However, that amendment does not affect our decision in this case, because the amendment applies to tax years beginning on and after July 1, 1997. Or Laws 1997, ch 541, § 464. The legislature also amended ORS 307.110(5), but that subsection is not relevant to this case. Or Laws 1997, ch 819, § 12.

The second difficulty is that taxpayer overlooks the grammar of the sentence as a whole. Taxpayer's argument suggests that "value thereof" refers back to the "lease," so that it is the leasehold interest that is to be assessed and taxed. That suggestion is at odds with the text.

With the modifying clause removed, the core text of ORS 307.110(1) (1995) provides: "all real and personal property * * * of any * * * municipal corporation * * * shall be subject to assessment and taxation for the real market * * * value thereof." "Thereof" refers back to the noun "property" (i.e., all real and personal property of a municipal corporation). The modifying clause in the middle of the sentence modifies the noun "property." As the sentence is structured, it means that all real and personal property of a municipal corporation is subject to assessment and taxation for the value thereof, if that property also meets the additional limitations in the sentence. Specifically, the phrase "held under a lease or other interest or estate less than a fee simple, by any person whose real property, if any, is taxable, except employees of the state, municipality or political subdivision as an incident to such employment" is an adjectival clause that modifies the noun "property." In other words, the modifying phrase concerning leases serves only to limit which pieces of governmental real and personal property are "subject to assessment and taxation for the real market * * * value thereof." Under ORS 307.110(1) (1995), only those pieces of governmental property that are "held [by a nonexempt taxpayer] under a lease or other interest or estate less than a fee simple" are "subject to assessment and taxation for the real market * * * value thereof"; governmental property held otherwise is not subject to assessment or taxation. That which is to be taxed or not taxed, as the case

may be, is the real market value of the piece of governmental property.

Context supports our reading of the text. In general, all property of the state and its subdivisions is exempt from taxation. ORS 307.090(1).[5] ORS 307.110, the statute under consideration here, is one in a series of statutory exceptions to that general rule of exemption of governmental property. See, e.g., ORS 307.095 (state property rented to private individuals for parking purposes is subject to ad valorem taxation); ORS 307.100 (government property held by a taxable owner under a contract of purchase is taxable). Structurally, then, ORS 307.110 restores to the tax rolls property that ORS 307.090(1) removed.

More specific contextual clues send the same message. For example, ORS 307.110(2) provides:

> "Each leased or rented premises not exempt under ORS 307.120 and subject to assessment and taxation under this section which is located on property used as an airport and owned by and serving a municipality or port

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[5] ORS 307.090(1) provides:

> "Except as provided by law, all property of the state and all public or corporate property used or intended for corporate purposes of the several counties, cities, towns, school districts, irrigation districts, drainage districts, ports, water districts, housing authorities and all other public or municipal corporations in this state, is exempt from taxation."

shall he separately assessed and taxed." (Emphasis added.)

That subsection makes clear that the things that are "subject to assessment and taxation" under ORS 307.110 are "premises" or particular pieces of property, rather than legal interests (such as leases) in such premises.

Similarly, ORS 307.110(3) provides that several kinds of "publicly owned property" that otherwise would be included in the general description of ORS 307.110 are not subjected to assessment or taxation. That list excepts certain pieces of property, not legal interests in those properties, from the command of ORS 307.110.

This court's previous construction of the pertinent statutory wording confirms the foregoing interpretation. In Johnson v. Dept. of Revenue, 292 Or 373, 639 P2d 128 (1982), the court held that, under ORS 307.110 (1977), submerged and submersible land owned by the state and leased to a nonexempt taxpayer was subject to ad valorem property taxation by Clatsop County, to the full value of the land. The key wording of ORS 307.110(1) was the same then as it is now. See Johnson, 292 Or at 376 (quoting statute) . After noting that ORS 307.110 is an exception to the exemption from taxation of public property, id. at 377, the court held that, under ORS 307.110, "the tax is assessed upon the full property value," even though the lien

resulting from the tax is enforceable only against the nonexempt taxpayer's leasehold interest, id. at 383.[6]

The legislature's intention is clear at the first level of analysis. We conclude that ORS 307.110(1) (1995) makes public property that is leased to a nonexempt taxpayer taxable. Further, ORS 307.110(1) (1995) subjects such property to assessment and taxation at its full value if the lessee has full use of the property for private gain. The Tax Court did not err in so concluding.

Taxpayer next argues that such an interpretation of ORS 307.110(1) (1995) makes it unconstitutional as a non-uniform method of taxation, in violation of Article I, section 32, and Article IX, section 1, of the Oregon Constitution, or as a violation

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[6] The method of assessing and taxing leased public property, which this court described in Johnson, is the same as the method of assessing and taxing leased private property, which this court described in Swan Lake Mldg. Co. v. Dept. of Rev., 257 Or 622, 625, 478 P2d 393, 480 P2d 713 (1971):

> "In fixing the true cash value of land for property tax purposes the effect of existing leases on the value to the owner is disregarded. The basis for such a principle is that the tax is levied upon the land and is a tax upon all the interests into which the land might he divided. Admittedly, a lease might decrease the price which the owner might receive; however, the tax is not merely upon the owner's interest; the tax is upon all the interests in the land, including the leasehold interest. That is so because of the corollary principle that taxes are assessed only against the one having title[.]

of the privileges and immunities clause of Article I, section 20, or as a violation of the Fourteenth Amendment to the United States Constitution. None of those arguments is well taken, and none of them requires discussion here. The Tax Court did not err in rejecting taxpayer's constitutional contentions.

Taxpayer's final argument is that the remaining length of the lease term is a "governmental restriction as to use," ORS 308.205(2)(d), that must be taken into account in assessing the property, because the term of a government lease affects the value of the leasehold interest. The pertinent statute does not, however, take account of every restriction that affects the value of the subject property; it covers only "governmental restriction[s] as to use." ORS 308.205(2)(d) provides:

> "If the property is subject to governmental restriction as to use on the assessment date under applicable law or regulation, real market value shall not be based upon sales that reflect for the property a value that the property would have if the use of the property were not subject to the restriction unless adjustments in value are made reflecting the effect of the restrictions."[7]

This court interpreted that statute in detail in Bayridge Assoc. Ltd. Partnership v. Dept. of Rev., 321 Or 21, 27-29, 892 P2d 1002 (1995). Examining the meaning of the noun "use," the court stated that a "governmental restriction as to use" refers to "a governmental restriction as to the method or manner of using the

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[7] Other portions of ORS 308.205 were amended during the 1997 legislative session. Or Laws 1997, ch 541, § 152. Those amendments are not relevant to this case.

property in question, or as to how the property is employed or occupied." 321 Or at 29.

The Tax Court held that several provisions in the lease here are governmental restrictions as to use.

> "For example, the lease specifies that the property can only be used as a Sheraton Motor Hotel * * *. The lease also specifies that: (1) taxpayer may have no banner signs or other advertising devices on the property, (2) the improvements must be maintained without alteration or improvements, (3) the hotel must be operated every day of the year 24 hours per day, and (4) the Port has a right to maintain air flights over the property." 14 OTR at 101-02.

The Tax Court held, however, that the term of the lease "does not limit the use of the property," even though it limits the leasehold interest. Id. at 102 (emphasis in original). See R.L.K. and Co. v. Tax Commission, 249 Or 603, 606, 438 P2d 985 (1968) (under analogous provision of ORS 307.060 (1967), lessee has full use of public property for each year the lessee remains in possession under the lease, notwithstanding limited term of lease). We agree that the nature of the use is not necessarily restricted by a limitation on the length of the use and that ORS 308.205(2)(d) pertains only to the former. The Tax Court did not err in applying that statute to the facts of this case.

Finally, apart from the legal arguments discussed above, in this court taxpayer does not challenge the reasonableness of the assessed value of the subject property. Accordingly, the Tax Court did not err in sustaining the department's order of assessment for $9,460,000.

The judgment of the Tax Court is affirmed.

APPENDIX B

IN THE OREGON TAX COURT

Property Tax

No. 3812

HAROLD POLLIN,	)
	)
Plaintiff,	)
	)
v.	)
	)
DEPARTMENT OF REVENUE,	)
STATE OF OREGON,	)
	)
Defendant.	)

OPINION

Plaintiff (taxpayer) appeals the July 1, 1993, assessed value of land leased from the Port of Portland (the Port) and the assessed value of taxpayer's improvements located on that land. ORS 307.110,[8] which subjects publicly owned property to taxation when leased for private use, gives rise to conceptual as well as factual issues.

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[8] All references to the Oregon Revised Statutes are to the 1993 Replacement Part.

FACTS

The Port is a municipal corporation and operates a wide range of facilities, including the Portland International Airport. In 1972, taxpayer and the Port executed a lease for land immediately adjacent to an airport runway. The lease obligated taxpayer to construct improvements to be used as a full-service Sheraton Motor Hotel. The lease restricts the use of the property to a "motor hotel," unless the lessee obtains the lessor's written consent for another use. The original lease term is 40 years, with a 10-year option. The rent is based on a percentage of income with a minimum annual rent. Taxpayer also agrees to pay any taxes that might be imposed on the premises. The lease requires taxpayer to maintain the improvements to original standards and also specifies a minimum original dollar investment. No modifications can be made to the improvements without the Port's approval. The lease also grants taxpayer an option to obtain use of adjoining land for expansion of the hotel, but that option expired.

Title to the improvements remains with taxpayer until termination of the lease, at which time the Port can elect to accept title or require taxpayer to remove the improvements. The lease also contains provisions for insurance, damage, condemnation, assignment, holding over, default, and other usual terms. Because of the location, taxpayer agrees to abide by FAA rules and the Port's rules governing the airport. The Port expressly reserves the right to maintain flights over the property with the consequent noise. The motor hotel and its restaurant must operate 365 days per year. The Port seeks to maximize its income and can disapprove of particular employees of taxpayer. Subsequent amendments to the original lease pertain primarily to rent and

options to expand the hotel area. Taxpayer may pledge the improvements, but not the land, as security for a loan.

ISSUE

What is the proper valuation of public property leased by a taxable lessee?

COURT'S ANALYSIS

ORS 307.110(1) provides as follows:

> "Except as provided in ORS 307.120, all real and personal property of this state or any institution or department thereof or of any county or city, town or other municipal corporation or political subdivision of this state, held under a lease or other interest or estate less than a fee simple, by any person whose real property, if any, is taxable, except employees of the state, municipality or political subdivision as an incident to such employment, shall be subject to assessment and taxation for the real market or specially assessed value thereof uniformly with real property of nonexempt ownerships."

Although the wording in the statute appears clear, questions arise when principles of property tax assessment are actually applied. Those questions are governed by statutes. Although the statutes reflect general principles of taxation, their construction is governed by legislative intent, particularly as discerned and expressed in Oregon Supreme Court decisions.

WHAT IS BEING ASSESSED?

With few exceptions, public property is exempt from property taxation. ORS 307.090. One exception is when public property is leased to a taxable lessee. ORS 307.110(1). Although leased public property becomes taxable, only the lessee's interest in the property is subject to assessment. See e.g., P.G.E. Company v. Tax Com., 249 Or 239, 437 P2d 827 (1968). As stated by the Oregon Supreme Court:

> "Because ORS 307.110 provides for the taxation of 'all real property of this state * * * held under lease,' and because ORS 307.110(4) makes general lien law applicable, we conclude that the tax is assessed upon the full property value, but the lien resulting from tax is enforceable only against the leasehold interest." Johnson v. Dept. of Rev., 292 Or 373, 383, 639 P2d 128 (1982).

It may be helpful to consider, by way of contrast, the assessment of leased private property. In that situation, both the lessor and the lessee are subject to tax. However, for administrative convenience, only one assessment is imposed to tax all of the interests. Sproul et al v. Gilbert et al, 226 Or 392, 421, 359 P2d 543 (1961). The assessor disregards the effect of the lease on the value to the owner because "the tax is levied upon the land and is a tax upon all the interests into which the land might be divided." Swan Lake Mldg. Co. v. Dept. of Rev., 257 Or 622, 625, 478 P2d 393 (1971).

When publicly owned property is leased to a taxable lessee, the public' s interest in the property remains exempt from taxation. Although the public interest remains exempt, the value

of the taxable interest of the lessee is measured by the full value of the property (unless restricted as to use). In effect, the statute makes all of the property taxable, but imposes the liability only upon the interest of the lessee.

WHAT IS THE VALUE OF THE PROPERTY INTEREST BEING ASSESSED?

ORS 307.110(1) provides that public property:

> "held under a lease * * * shall be subject to assessment and taxation for the real market or specially assessed value thereof uniformly with real property of nonexempt ownerships."

The Oregon Supreme Court has construed this language to mean that if the taxable user of the property has full use of the property, it is to be taxed at the full value. The court stated:

> "If the possessor is making a full use of the property, the value to him is exactly the same as it would be were he the owner. In effect, the lessee is the owner for each tax year he remains in possession under his lease, subject to any diminution in value resulting from restrictions made applicable to him which would not be applicable to an owner in fee." R.L.K and Co. v. Tax Commission, 249 Or 603, 606, 438 P2d 985 (1968).

Thus, for tax purposes, the value of the lessee's interest is the value of the property as used.

Taxpayer contends that taxing a lessee's interest at the full value of the property is unconstitutional. Measuring the value

of the taxable lessee's interest by the full market value of the property may produce a larger tax, but it is not unconstitutional. It reflects a legislative intent that a private lessee using public property should pay taxes commensurate with the use of the property.

In the instant case, there is potential for confusion because taxpayer leases public land but owns the improvements located on the land. To the extent the improvements are subject to restrictions contained in the lease, their taxable value may be diminished. However, only those lease terms that restrict the use of the improvements have the potential for reducing their taxable value.

In summary, under ORS 307.110, the lessee's interest in government-owned property is taxed at the full value of the property if the lessee has full use of the property for private gain. Taxation at full value places that use on the same level as other taxable property. Contrary to taxpayer's arguments, the legislature did not intend government lessees to obtain a competitive advantage.

WHAT CONSTITUTES A GOVERNMENTAL RESTRICTION ON USE?

Any restriction on the use of property imposed by government constitutes a governmental restriction. The most common form of restriction is zoning, which limits the use of property. Such limitations affect the highest and best use of the property and, consequently, affect the property's market value.

Although ORS 308.205(2)(d)[9] concerns governmental restrictions under "applicable law or regulation," that statute does not exclude other forms of governmental restrictions. It merely directs that if use of the subject property is restricted "under applicable law or regulation," any comparable sales used in assessing the property for taxation must be subject to like restrictions or be adjusted for such restrictions. As indicated in Bayridge Assoc. Ltd. Partnership v. Dept. of Rev., 321 Or 21, 28, 892 P2d 1002 (1995), governmental restrictions on the use of property may be the result of a statute or a contract, such as a lease or covenant. The restrictions need not be involuntarily imposed and may result in an economic benefit to the taxpayer.

In this case, the provisions in the lease that limit the use of the property are governmental restrictions. For example, the lease specifies that the property can only be used as a Sheraton Motor Hotel, implicitly incorporating conditions required for obtaining and using a license from the Sheraton Motor Hotel chain. The lease also specifies that: (1) taxpayer may have no banner signs or other advertising devices on the property, (2) the improvements must be maintained without alteration or

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[9] ORS 308.205(2) (d) provides:

> "If the property is subject to governmental restriction as to use on the assessment date under applicable law or regulation, real market value shall not be based upon sales that reflect for the property a value that the property would have if the use of the property were not subject to the restriction unless adjustments in value are made reflecting the effect of the restrictions."

improvements, (3) the hotel must be operated every day of the year 24 hours per day, and (4) the Port has a right to maintain air flights over the property. All of these provisions can affect the income or benefits to be derived from the property.

Taxpayer claims that the term of the lease is a governmental restriction. Although the term of the lease is a limitation on taxpayer's leasehold interest, it does not limit the use of the property. As explained by the Oregon Supreme Court:

> "The state would have the power to impose a tax on all lessees of real property upon the basis of the full value of the land, just as it may, and ordinarily does, tax lessors for the full value of the land. If one were to buy a lessee's interest, the price would not be determined by the value of the entire fee but upon the basis of the value of the term. But we are not concerned with a sale of property in this case; the evaluation is made for the purpose of taxation. The value of property is in its use. The state can tax that value to the person who, for the tax period, is using it. If the possessor is making a full use of the property, the value to him is exactly the same as it would be were he the owner. In effect, the lessee is the owner for each tax year he remains in possession under his lease, subject to any diminution in value resulting from restrictions made applicable to him which would not be applicable to an owner in fee." R.L.K. and Co., 249 Or at 606.

Similarly, restrictions on financing, pledging, and transferring interests are not restrictions on use, but are restrictions on taxpayer's interest in the property. To paraphrase the RLK and Co. case, the court is not concerned with the sale or financing of

a taxpayer's interest. Rather, it is concerned with the value of the property as it is used.

Having determined what constitutes a governmental restriction, the court must now determine what effect the governmental restrictions have on the market value. This must be determined from the evidence submitted by the parties.

Taxpayer's appraiser, Mr. Glanville, appraised the property in 1992 for a lending institution in connection with taxpayer's efforts to finance improvements.[10] His assignment was to value the leasehold estate, which had 29 years remaining (including the option) with no reversion available. (Ex 4, at 00060.) Glanville did not appraise the property specifically for purposes of determining its taxable value under ORS 307.110. Consequently, he missed the target by taking into consideration factors not appropriate for reliance or deduction. For example, his appraisal states:

> "The lease agreement does not permit subordination for mortgage purposes. Thus, the lenders' collateral is a stream of income for the next 29 years, with no interest in the land or the building residual at the end of that lease. This has a substantial effect on the value, because of the short remaining term of this lease, which becomes more precarious as the end of the term approaches." (Ex 4, at 00007.)

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[10] Glanville updated the appraisal for this litigation and derived a value for the property as of July 25, 1993.

Elsewhere, the appraisal states that "[e]xtending the term of this lease could have a dramatic impact depending upon the length of the extension and the terms of the renegotiated lease." (Ex 4, at 00012.) Glanville recognizes that a leasehold in land has value only when the contract rent is less than market rent, or when the lessee improves the land with a building, adding value to the leased property. In this case, he found that lease rent was market rent. His question of value then was simply the value of the improvements. (Ex 4, at 00057.)

Glanville found that the highest and best use of the subject property is as improved. Although he recognized the Port's long-term plan to use the land for airport purposes and move the hotel elsewhere, his analysis of relative values shows that the current use results in the greatest value. (Ex 4, at 00055.)

In considering the three approaches to value, Glanville determined that the cost approach was not appropriate because the hotel had been built in stages over time. The different stages resulted in varying degrees of depreciation, which is difficult to measure. In the sales comparison approach, he used eight comparable sales. Only one sale was on leased property and that lease period was so long that the arrangement was viewed as equivalent to a fee ownership. (Ex 4, at 00062.) Glanville used these comparable sales to estimate the fee value of the property. He deducted from the fee value the value of the leased fee estate, which he calculated using a discounted cash flow for 29 years.

Based on his analysis, Glanville found an indicated fee value of $55,000 per room and a gross income multiplier of 1.65. Applying these indicators, he estimated a full market value for the

land, buildings, and personal property of $12 million (rounded). He calculated the value of the leased fee estate at $3.36 million, leaving an estimated value of the leasehold estate of $8.64 million. (Ex 4, at 00077.)

In the income approach, Glanville projected income and expenses based upon the history of the subject property. He then compared those figures with standard industry performances published by Pannell, Kerr, and Forster (PKF) in Trends in the Hotel Industry - 1992. This permitted him to compare categories of expenses and income on a percentage basis. He also compared income and expense information with other comparable hotels in the Northwest. This latter information is confidential and he did not identify the specific hotel properties. (Ex 4, at 00082.) His income approach indicated a real market value of $12 million for the fee estate. (Ex 4, at 00096.) Again, because taxpayer does not own the fee estate, Glanville adjusted the discount rate to calculate the leasehold value at $7.1 million. (Ex 4, at 00099.)

It should be noted that this indicated value is based on net cash flow after deducting lease payments. (Ex 4, at 00095.) Deducting lease payments removes the value of the leased property from the calculation. Delta Air Lines, Inc. v. Dept. of Rev. (II), 13 OTR 372, 377 (1995), appeal pending. In effect, Glanville calculated only the value of taxpayer's interest in the improvements. This is not consistent with ORS 307.110, which measures the tax by the value of the leased land.

In his reconciliation, Glanville determined that the $7.1 million represented the value of taxpayer's leasehold interest. In his testimony, he stated that the value included personal

property of $1,505,000, leaving a value for the real property of $5,595,000. Further, he believed that value would have been approximately $1 million less by the end of the tax year, which would be the lowest value during the period measured by ORS 308.205.

Three other appraisal experts testified for taxpayer that Glanville's analysis was correct in methodology and met acceptable professional standards. None of the appraisal experts had an opinion of value for the subject property.

Also testifying for taxpayer were two market experts involved in hotel financing. Both confirmed that the term of the lease was a restriction on the property that affected the risk recognized by the market. One of the witnesses made a "wild stab" at estimating a capitalization rate, but the court considers that estimate too speculative. The other witness was involved in renegotiating the lease for the subject property for later years.

Although Glanville's appraisal is thorough, well-written, and consistent with appraisal principles, it was not prepared for this tax appeal and does not focus on the correct value. His appraisal estimates the value of taxpayer's leasehold estate. What is needed is an estimate of the value of the property used by taxpayer. The most critical difference between the two estimates is the lease term. Glanville views the limited term as greatly reducing his estimate of value even though it does not affect the use of the property.

There are lease restrictions which might diminish the taxable value, such as being required to use the property only as a Sheraton Motor Hotel. However, no evidence specifically

addressed that issue, and the court is unable to determine whether those restrictions had a positive or negative effect on value. In short, taxpayer failed to carry his burden of proof.

Although taxpayer failed to carry his burden of proof, the court will examine the department's appraisal evidence. Under ORS 305.435, if the evidence indicates a greater or lesser amount is appropriate for the assessed value, the court is authorized to make that determination.

Mr. Rodwick, a Multnomah County appraiser, testified for the department that his assignment was to determine the fee simple interest value of the land and buildings. Like taxpayer's appraiser, he found that the highest and best use of the property was as improved and that the cost approach was not appropriate.

Rodwick found only two comparable hotel sales for use in his sales comparison approach. Based on those sales, he derived a value per room of $50,000, resulting in an indicated value of $10,750,000 for the subject property. In the income approach, like Glanville's, he used the subject's actual income and expenses and compared those figures to the PKF industry trends. He also compared the subject's income and expenses with other confidential hotel information. Taxpayer moved to exclude Rodwick's appraisal because he refused to disclose the confidential information on cross examination. The department did not seek a protective order under ORS 305.430(3). Accordingly, the court will exclude the confidential information in evaluating Rodwick's appraisal opinion.

Based on the information available to him, Rodwick calculated an overall capitalization rate of 12 percent, which, when applied to his calculated net income, gave him an indicated value of $11 million for the subject property. In his reconciliation, Rodwick gave the greatest weight to the income approach and concluded that the subject property had a market value of $11 million.

The court finds that Rodwick's appraisal also misses the mark. Rodwick testified that none of the conditions in the lease constituted governmental restrictions. As explained above, when the government is the lessor, lease provisions restricting the use of the property constitute governmental restrictions. Such restrictions can diminish the taxable value of the lessee's interest. If this were not the case, a lessee would be taxed on the value of use he does not have. The legislative intent is to tax the private lessee for the full value of the property use made available to the lessee, not some hypothetical use prohibited by the lease.

Neither party introduced evidence that persuades the court that the assessed values are erroneous. The total assessed value as of July 1, 1993 is $9,460,000. The assessed value of the land, which is the only property leased and assessable under ORS 307.110, is $1,246,000. This is reasonable in light of the evidence submitted. Similarly, the assessed value of $8,214,000 for the improvements owned by taxpayer is consistent with the evidence submitted. Consequently, the court must sustain the

department's Opinion and Order No. 94-2477. Judgment will be entered in accordance with this opinion. Costs to neither party.

Dated this 10th day of January, 1997.

/s/ Carl H. Byers
JUDGE